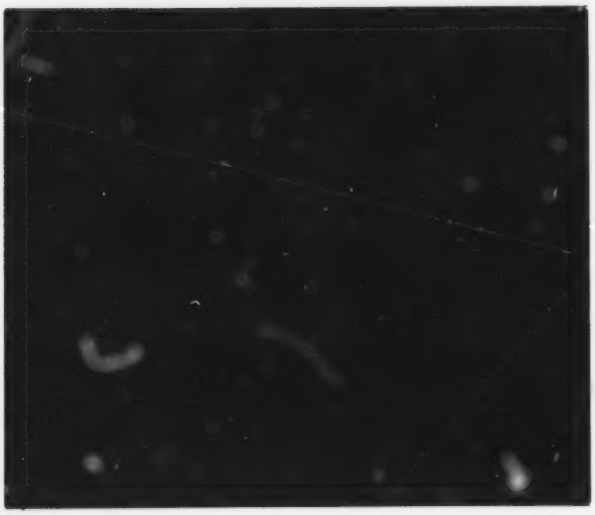
Province of British Columbia
Ministry of Finance and Corporate Relations



DISCUSSION PAPER

AMENDMENTS TO THE REAL ESTATE ACT AND THE MORTGAGE BROKERS ACT

January 19, 1990

TABLE OF CONTENTS

PAGE

FOREWORD

CHAPTER 1 - AMENDMENTS TO THE REAL ESTATE ACT

1. INTRODUCTION 1

2. MAJOR POLICY ISSUES

° Regulatory Responsibilities 2

° Reorganization of Ministerial Responsibilities 3

° Disclosure Requirements 3

° Recovery Fund 5

° Licensing Requirements - Business Brokering 6

° Licensing - Salesmen 7

3. HOUSEKEEPING CHANGES AND MINOR AMENDMENTS TO THE ACT

° Section 1 - Definition of "Agent" 8

° Section 1 - Definition of "Salesman" 8

° Section 2 - Salaried Sales Staff 9

° Section 3 - Nominees of Agent 9

° Section 14 - Trust Funds in British Columbia 10

° Section 15 - Agent to Act as Stakeholder 10

° Section 16 - Unclaimed Trust Funds 10

° Section 20 - Receiver of Trust Funds 11

° Section 25 - Guarantees of Resale 11

° Section 28 - Duty to Disclose Interest 12

° Section 48 - Agent to Act as Stakeholder 12

	PAGE
4. HOUSEKEEPING CHANGES TO THE REGULATIONS	
° Regulation 4.01	13
° Regulation 4.10	13
° Regulation 4.18	13
° Regulation 5.02	13
° Regulation 5.03	14
° Regulation 6.01 and Regulation 9.16	14
° Regulation 9.17	14
° Regulation 9.18	14
° Regulation 12.01	15
° Regulation 12.05	15
° Regulation 14.02	16
° Regulation 10/85	16
5. CONCLUSION	16
CHAPTER 2 - AMENDMENTS TO THE MORTGAGE BROKERS ACT	
1. INTRODUCTION	17
2. DEEMED REGISTRATION	18
3. LICENSING CATEGORIES	18
4. LICENSING REQUIREMENTS	19
5. DISCLOSURE - CONVENTIONAL MORTGAGES	20
6. DISCLOSURE - SYNDICATED MORTGAGES	21
7. TRUST ACCOUNTS	22
8. FINANCIAL STATEMENTS	23
9. REGULATORY POWERS	23
10. CONCLUSION	24

DISCUSSION PAPER

Foreword

This discussion paper sets out proposed changes to the Real Estate Act and the Mortgage Brokers Act. It reflects a commitment on the part of this government to update and modernize real estate legislation in this province. As well as changes proposed in this paper, a second discussion paper outlining proposed changes to the Condominium Act will be released in the near future.

These two acts are under review together because of the obvious connection between real estate and mortgage brokering activity. The Real Estate Act licences and administers real estate agents and salesmen. Many of these agents and salesmen also engage in mortgage brokering, both as a separate occupation and as part of their duties as realtors. Changes to the Mortgage Brokers Act will effect these realtors. Changes to the Real Estate Act may also affect those mortgage brokers who are licensed only under the Mortgage Brokers Act.

The intent of the proposed changes is to modernize and clarify the legislation and to improve public protection, especially protection for those who invest in mortgages. This represents a continuation of the process of revising and reforming legislation related to the corporate and financial sectors. Recent legislation includes the Financial Institutions Act (FIA), the Credit Union Incorporation Act (CUIA) and the Personal Property Security Act (PPSA). The intention is to continue the process in future, including a major review of the Company Act.

It is anticipated that legislation to implement the changes proposed in this paper will be introduced in the Spring of 1990. Please direct your comments, by **February 28, 1990,** to:

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CHAPTER 1

AMENDMENTS TO THE REAL ESTATE ACT

1. INTRODUCTION

The regulatory framework of the Real Estate Act is being reviewed at this time for a number of reasons. The basic policy of the Act has not been re-examined since its enactment in 1958. The creation of the Financial Institutions Commission and the consequential changes in the Office of the Superintendent of Real Estate, the growing acceptance of self-regulatory organizations and the general acceptance and effectiveness of recent amendments to the Real Estate Act all indicate that further changes to the Real Estate Act may be warranted. Further, changes currently under study to the licensing schemes for securities dealers and insurance agents suggest changes to the manner in which the Real Estate Act licences members of the real estate industry.

Chapter 1 examines these broad policy questions and proposes changes to the administration and licensing requirements of the Real Estate Act.

The administrative changes proposed in this chapter reflect a desire to make the real estate profession responsible for its own regulation on a day-to-day basis. The proper role of government in regulating professionals is to protect the public interest by providing broad supervision. The proposed changes suggest that the Ministry of Finance and Corporate Relations may no longer be the most appropriate ministry to discharge government responsibilities under the Real Estate Act.

The proposed changes to the licensing requirements of the Real Estate Act set out in this chapter attempt to remove barriers to participation while still ensuring public protection. The need for a licence under the Real Estate Act should not unduly restrict individuals who have valuable skills and knowledge from participating in the real estate industry.

Chapter 1 also examines the government's present responsibility to examine and approve the information provided to real estate purchasers. The additional cost to both the public and private sectors of government vetting disclosure statements must be balanced against the benefits derived from this procedure. Where government examination does not significantly increase public protection, it should be eliminated.

In addition, a number of housekeeping and minor amendments and improvements to the Act are proposed. These amendments do not reflect fundamental policy changes, but are improvements to specific sections of the Act or the Regulations, many of which have been proposed by the industry.

2. MAJOR POLICY ISSUES

Regulatory Responsibilities

Part 1 of the Real Estate Act (Act) provides for the licensing and regulation of real estate sales people. The Superintendent of Real Estate (Superintendent) is responsible under Part 1 of the Act for licensing and supervising real estate agents, nominees and salesmen. The Superintendent issues licences under sections 3 and 4 of the Act, and enforces compliance with the Act and with the regulations.

In practice, the functions of the Superintendent are quite limited. The Superintendent reviews the financial statements of real estate agencies under section 19 and investigates unlicensed real estate activity. Most of the other functions of the Superintendent have been delegated to the Real Estate Council (Council). The Council, for example, reports to the Superintendent on the qualifications of applicants and carries out various pre-licensing programs. The Council is also responsible for disciplinary inquiries and investigations into the conduct of licensees.

Additional functions could be performed by the Council. This would have the advantage of one body performing all the regulatory functions involving real estate licences and would increase the efficiency of regulation. The Council has proven to be a competent and effective administrator. The delegation of additional responsibility to the Council would be consistent with the recent provision of additional responsibility to the Insurance Council.

It is proposed that the responsibility and authority for all day-to-day regulatory functions involving real estate licensees be moved from the Superintendent to the Council. The Superintendent would be responsible for taking action against unlicensed real estate activity through civil injunctions and other remedies. The Superintendent would also provide general policy direction to the Council. Other functions would be carried out by the Council.

The increased independence and responsibilities of the Council also suggest that its financial flexibility should be increased. The Council currently collects licensing fees and remits a portion of the fees to the government. Licensing fees are set by regulation. The Council must currently cover its expenses from the portion of the fees it does not remit, as well as from the fund it raises from its assessments.

It is proposed that the Council finance its operations solely through assessments. Licensing fees would still be collected by the Real Estate Council, but all the fees would be remitted to the province. Licensing fees would be reduced to reflect this change.

Regulatory Responsibilities (Continued)

Changes are also proposed to the manner in which the Council accounts for its financing. Copies of the annual budget and financial statements would be filed with government regulators and submitted to all licensees. The Council would be required to comply with the reporting and disclosure imposed on other government boards and commissions by the Financial Information Act.

Reorganization of Ministerial Responsibilities

The proposed changes to the functions of the Superintendent outlined above provide an opportunity to reorganize responsibility for the real estate statutes. The primary purpose of Part 1 of the Act is the protection of real estate consumers, although commercial transactions are also regulated by the Act. The duties and responsibilities of the Superintendent are compatible with the other consumer related functions of the Ministry of Labour and Consumer Services.

The changes proposed in this paper and the changes made by the FIA alter the responsibilities of the regulators. The Superintendent of Financial Institutions will be the primary administrator and regulator of credit unions, trust companies and insurance companies. The Superintendent of Real Estate would not be the primary regulator but would only oversee the Council. This reduces the value of having these two functions (Superintendent of Real Estate and Superintendent of Financial Institutions) fulfilled by the same individual.

Therefore, the Minister of Finance and Corporate Relations and the Minister of Labour and Consumer Services propose that the Office of the Superintendent of Real Estate become part of the Ministry of Labour and Consumer Services.

Disclosure Requirements

Part 2 of the Act sets out the prospectus and disclosure requirements for selling various types of subdivisions including condominium developments, time-share developments, cooperatives and out-of-province subdivisions. Prospectuses and disclosure documents must be distributed to persons purchasing these properties directly from the developer. The purpose of this provision is to ensure that purchasers of these types of developments have the necessary information to evaluate their prospective purchase.

Part 2 currently sets out a complex process for receiving permission to market real estate developments that have not yet been registered at a Land Title Office. Developers must

Disclosure Requirements (Continued)

keep deposits in trust accounts, obtain the necessary municipal or regional approval and submit prospectuses or disclosure statements for vetting by the Superintendent in order to market these developments. Prospectuses are subject to lengthy and time-consuming examination by government officials.

Beginning in 1986, developers were allowed to file disclosure statements in place of prospectuses. Disclosure statements are considerably easier and less expensive to prepare than prospectuses. In most cases, disclosure statements are filed without any review by government officials. No attempt is made by the Superintendent to ensure that the disclosure statement complies with Part 2 of the Act. In practice, a large majority of developments that are not time-sharing agreements or out-of-province subdivisions use disclosure statements rather than prospectuses.

The process for marketing unregistered developments could be further streamlined. The option of using prospectuses is confusing and unnecessary in most cases. Disclosure statements are more convenient for the developer and serve to inform the public as effectively as do prospectuses. Developers have a strong incentive to prepare complete and accurate disclosure statements because of the civil and criminal consequences which could result from misrepresentation. Developers are liable for large fines if the disclosure statements are inaccurate and purchasers may rescind a purchase if disclosure statements do not comply with the Act. In practice, very few complaints are received about disclosure statements which have not been reviewed by officials and few of those reviewed are rejected.

It is proposed that Part 2 of the Act be amended to streamline the disclosure process. The requirement that disclosure statements be provided to persons purchasing unregistered strata units and cooperatives directly from the developer would remain. Developers would be allowed to use disclosure statements rather than prospectuses to sell time-share agreements. However, it is proposed that the format of disclosure statements be altered to improve disclosure regarding a number of issues including, for example, restrictions on the use of strata lots or the existence of recreational facilities. In addition, it is proposed that disclosure statements no longer be filed with the Superintendent or vetted by any government agency. Instead, copies of the disclosure statements provided to purchasers would have to be filed at the Land Title Office.

Disclosure Requirements (Continued)

It is proposed that the documents required to file a disclosure statement also be changed. Disclosure statements would have to be accompanied by affidavits from the developer signifying that full disclosure has been made, and from a solicitor representing the developer stating that all the technical requirements of the Act have been complied with.

It is proposed that prospectuses only be required from out-of-province developers. These prospectuses would receive full examination by the Superintendent and the fees would be increased to reflect the true cost of examination. Vetting for these developments is necessary because of legal problems of applying British Columbia law in respect of properties out of the province.

These amendments should make real estate development less costly and more efficient, while still providing purchasers with adequate disclosure. In fact, disclosure will be improved.

Recovery Fund

Section 5 of the Act requires the Superintendent of Real Estate or the Real Estate Council to ensure that licensees have furnished security under the Bonding Act. This provision allows consumers to claim against a bond where a licensee has misappropriated funds. Currently, each licensee or real estate firm must independently purchase these bonds.

The current reliance on private bonding has resulted in a number of inefficiencies. The protection consumers enjoy under the bonding requirement is not uniform and can vary from $10,000 to $100,000, depending upon the number of licensees employed at the real estate firm. Furthermore, although bonding can be expensive to obtain, there have been very few claims against bonds since this requirement was imposed in 1958.

It is proposed that a recovery fund be established to replace the existing surety bond requirement. Licensees would be required to participate in the fund. Amendments to the Act under this proposal would establish a separate corporation to create and administer a recovery fund to replace private surety bonds. The corporation operating the fund could share administrative facilities with the Real Estate Errors and Omissions Insurance Corporation, but would remain a separate entity and would be regulated as an independent insurance company. Cross-subsidization between the recovery fund and the Real Estate Errors and Omissions Insurance Corporation will not be permitted as it is important that licensees be aware of the real cost of liability insurance.

Licensing Requirements - Business Brokering

Section 1 of the Act defines "real estate" to include:

> a business and the goodwill and assets of it, and an interest, partnership or share in a business or in the goodwill or assets of it;

Section 1 also defines "business" to include:

> an undertaking carried on for gain or profit ...

The definitions of "real estate" and "business" ensure that anyone acting as an agent in the sale of a business in British Columbia must have a real estate licence. As a result of these definitions, real estate includes all businesses even if the assets of the business do not include land. Only persons licensed under the Act are allowed to charge a fee for disposing of real estate.

Requiring a real estate licence to sell a business provides the public with certain safeguards. Real estate licensees must be insured and bonded. As well, licensees must demonstrate a certain level of expertise concerning the sale of an asset. Finally, most licensees are members of a professional organization which ensures compliance with standards of professional conduct.

However, other professions could offer the same safeguards to a party wishing to sell a business which does not contain a significant real estate component. Other professions are required to be bonded, to carry insurance, and to have a professional organization to ensure compliance with practice standards. As well, the expertise of other professions may be more relevant to the sale of a particular business, especially if real estate does not form part of the assets of the business. The public should be free to decide which profession is most suitable to act in the sale or purchase of a business.

It is proposed that the definition of "real estate" be amended to include only those businesses which contain a significant real estate component. Furthermore, anyone acting for or on behalf of another person in the sale of a business which does <u>not</u> include a real estate component would be required to hold a new class of licence - a business brokering licence. All existing and future licensed real estate agents would be automatically provided with a business brokering licence. However, anyone else wishing to participate in business brokering would have to apply for such a licence.

Applicants for a business brokering licence would have to show that they can offer the public the same safeguards as real estate licensees. They would have to be bonded and

Licensing Requirements - Business Brokering (Continued)

carry insurance. They would also be required to be members of a professional organization which ensures compliance with professional standards and would regulate the licensees in place of the Council. Finally, the profession must offer particular expertise which would be relevant to a person buying or selling a business. These professions will be listed in the regulations to the Act and will include chartered accountants, certified general accountants and lawyers.

Licensing - Salesmen

An "agent" is defined in section 1 of the Act as a person who engages in certain specified activities. A "salesman" is defined in the Act as a person employed by an agent to do any of the activities referred to in the definition of agent.

The types of employment in which a real estate salesman is entitled to engage are currently limited by Regulation 9.13 to being a real estate salesman, an insurance salesman or an insurance agent. A real estate salesman may not have any other concurrent employment.

Applicants for an agent's licence are required, under section 4.02 of the regulations, to have served as a licensed salesman for two of the last five years. To ensure that agents have acquired practical knowledge of the real estate industry, it is necessary that the salesman be employed full-time in the marketing of real estate or in the related field of insurance.

However, the restriction on other occupations cannot be justified on the ground of ensuring adequate training for agents. Many salesmen remain salesmen for the length of their careers. Furthermore, all real estate transactions conducted by a salesman must be supervised by an agent. What other occupations a salesman may be engaged in should be a matter of a private employment contract between the salesman and the agent.

It is proposed that salesmen be allowed to engage in any occupation which they and their employers feel appropriate and which does not create a conflict. However, under this proposal, applicants for an agent's licence would still have to show they have been engaged as full-time real estate salesmen for two of the last five years.

3. HOUSEKEEPING CHANGES AND MINOR AMENDMENTS TO THE ACT

Section 1 - Definition of "Agent"

Section 1 of the Act defines "agent" to include:

> "a person who, on behalf of another, for or in expectation of a fee, gain or reward, direct or indirect, from any person,...
>
> (d) collects or attempts to collect money secured by a charge on, or transfer, of real estate, or money payable as rent for the use of real estate;

This definition is too broad, as it includes a person who collects a rent cheque and simply passes the cheque on to the owner of the real estate.

It is proposed that property managers be required to hold a real estate licence only if they are engaged in certain specified activities. A property manager will be required to hold a licence if he accepts rent, mortgage payments or strata fees in trust for the owners, or if he is responsible for paying repair or maintenance costs out of the trust funds. A licence will be required for these activities because they require the manager to exercise skill and judgment in a fiduciary capacity.

Section 1 - Definition of "Salesman"

A "salesman" is defined in section 1 as:

> a person, other than a nominee, employed by an agent, either generally or in a particular case, to do anything referred to in the definition of agent.

However, Regulation 9.15 creates a class of licensee which is neither clearly "salesman" nor "agent".

Regulation 9.15 allows the Superintendent to treat agents who are employed by other agents as if the employee-agents were salesmen. The definition of "salesman" does not adequately distinguish among agents, salesmen and agents licensed under Regulation 9.15 of the Real Estate Act regulations. The definition of "salesman" refers to all persons, other than nominees, employed by an agent, but does not specifically refer to Regulation 9.15 agents.

The definition of "salesman" should be clarified to specifically include Regulation 9.15 agents. The regulatory scheme of the Act is to treat all persons employed by an agent to sell real estate as a salesman. Although a person exempted under Regulation 9.15 holds an agent's licence, he is regulated as if he were a salesman, and the sections of the Act dealing with salesmen should apply to him.

Section 2 - Salaried Sales Staff

The current Act regulates salaried sales staff - salesmen employed for a salary by a developer - in an unclear and indirect manner. The Act does not apply to full-time salaried employees if they comply with the regulations to the Act. The only regulation relevant to salaried sales staff is Regulation 5.02, which prohibits a person from authorizing or circulating a false statement or representation. Therefore, by implication, the Act only applies to salaried sales staff in cases of misrepresentation.

Salaried sales staff do not require the same degree of regulation as do real estate agents. The developer is vicariously liable for the actions of the sales staff he employs. A member of the public can claim compensation directly from the developer for the actions of the sales staff. A member of the public may not be able to claim compensation from the owner if the misrepresentation is made by a real estate agent. Furthermore, the public is unlikely to rely on sales staff to safeguard their interests, while a real estate agent is often relied upon to protect the interests of the vendor or purchaser.

However, clear safeguards are required to prevent the public from being misled by these sales staff. It is proposed that a section be added to the Act which would prohibit sales staff or their employers from using or authorizing misleading statements. This amendment would provide a clearer deterrent than the present statute, as a misrepresentation would be considered an offence.

Section 3 - Nominees of Agent

Section 4 of the Act allows corporations and partnerships to hold an agent's licence as long as a qualified person is nominated to represent the corporation or partnership under the Act. A real estate agency may be owned by persons who are not licensed either as salesmen or as agents. This represents a temptation for the unlicensed owners to become involved in the day-to-day operations of the business. That is, corporate and partnership licensees may provide opportunities for unlicensed individuals to act as agents.

Dictating the manner in which real estate businesses are owned would be an unwarranted interference in the marketplace. However, some measures are necessary to ensure unlicensed owners realize that they cannot act as agents or salesmen under the Act.

It is proposed that the Act be amended to require all the beneficial owners of 10 per cent or more in a corporate application and all partners in a partnership application to be listed and the Council informed of anyone who acquires a 10 per cent or greater interest or becomes a partner. The Act would also require sworn undertakings from both the owners and the nominee that only licensed parties will engage in real estate business.

Section 14 - Trust Funds in British Columbia

Several sections of the Act require an agent to hold funds received in trust in a trust account. Requiring trust funds to be placed in a trust account allows regulators to place these funds under some degree of control.

At present, no restrictions are placed on the geographic location of an agent's trust account. Agents are required by the Act to place funds in a deposit account in a bank, trust company or credit union, but the financial institution is not required to be in British Columbia. An institution located outside the province would not have to comply with a Superintendent's order issued under section 20(11) to freeze the trust account.

It is proposed that section 14 be amended to require that an agent's trust account be kept at a financial institution located within the province.

Section 15 - Agent to Act as Stakeholder

Section 15 requires an agent to hold, in his trust fund, any money received by the agent in respect of a real estate transaction. However, section 15 does not require these deposits and other advances to be held by licensed agents pending the completion of the transaction. The deposit could be held by another party who is not a licensed agent.

Having a deposit held by a licensed agent provides safeguards to both the purchaser and the vendor. Auditing of trust accounts, licensing of agents and bonding requirements ensure that a deposit held by an agent will not be misappropriated. A vendor will usually assume that the deposit is held in trust by an agent and may not be aware that it is held by another party. Both the purchaser and the vendor should agree and be aware that a deposit is to be held by a party who is not a licensed agent.

It is proposed that section 15 of the Act be amended to require that all money paid in advance of a real estate transaction be paid to a real estate licensee unless all principals to the transaction agree otherwise.

Section 16 - Unclaimed Trust Funds

No provision currently exists to allow agents to disburse unclaimed trust funds. Section 16 of the Act sets out the conditions under which an agent may withdraw funds from his trust account. This section does not allow agents to disburse funds when they have not been able to locate their client for some length of time.

Section 16 - Unclaimed Trust Funds (Continued)

It is proposed that section 16 be amended to allow agents to pay unclaimed trust funds to the Minister of Finance and Corporate Relations. The Minister of Finance and Corporate Relations would, in turn, invest the funds pursuant to the provisions of the Unclaimed Money Act. However, agents would have to wait at least two years after their client first became entitled to the money before they can pay out the trust funds. The two-year waiting period is consistent with the provisions of the Unclaimed Money Act which requires the publication of lists of unclaimed deposits after two years.

Section 20 - Receiver of Trust Funds

Both the Superintendent and the Council are currently limited as to the control they may exercise over an agent's trust fund. Section 20 of the Act authorizes the Superintendent to order that trust funds not be withdrawn or transferred. The Superintendent must direct how these funds are to be used once such an order has been made. The Superintendent cannot delegate this authority, nor can a receiver be appointed over these funds.

The Superintendent needs additional flexibility when dealing with frozen trust funds. An agent may be holding rent, maintenance fees or other funds in trust on behalf of clients. The clients may have been relying on the agent to pay expenses out of these funds. The Superintendent is forced to either delay the payment of these expenses, or examine and authorize each individual expense item.

It is proposed that section 20(11) be amended to authorize the Superintendent, on the advice of the Council (or directly, if the public interest is at risk) to appoint a receiver to wind-up an agent's trust account. The Superintendent would be able to limit the authority of the receiver, and the receiver would be subject to the provisions of the Personal Property Security Act and the Law and Equity Act regarding receivers.

Section 25 - Guarantees of Resale

Real estate agents are permitted under section 25 to guarantee purchase or resale of property as an inducement to purchase or sell real estate. The section requires the guarantees be made in writing to the client. However, even written guarantees still pose a danger to the public that they may be misled. Recent experience has shown that few people question whether a guarantor has sufficient resources to honour claims.

Section 25 - Guarantees of Resale (Continued)

Regulation of guarantees should balance the protection of the public from potentially misleading promises against the rights of individuals to conduct their business in the manner they feel is most efficient. A guarantee that is not honored is a matter of private contract between two parties. No reason exists to ban completely the use of resale guarantees. Requiring agents to keep the funds necessary to honour resale guarantees in trust would impose an unreasonable cost on agents offering this service, and would constitute interference in the marketplace. Government regulation is required only where an agent making a guarantee does not reasonably expect to be able to fulfill the guarantee.

It is proposed that section 25 be amended to require agents to fulfill guarantees issued by them. Not fulfilling a guarantee will be considered misconduct by the agent under section 20 of the Act, unless he has reasonable grounds for having failed to do so.

Section 28 - Duty to Disclose Interest

Section 28 requires real estate agents to make certain disclosures to vendors of property. An agent must reveal that he is a real estate licensee and that he is purchasing the property on his own behalf, or on behalf of a company in which he has an interest. This requirement is designed to warn vendors that the purchaser is sophisticated in real estate transactions and is acting on his own behalf.

This section may occasionally impose an unreasonable and unnecessary burden on licensees. A licensee must reveal an interest in the purchasing company, no matter how small. A licensee may be a small shareholder in a large, national corporation that is involved in a real estate transaction. In many cases, a licensee may not even be aware that he is violating this section of the Act. A licensee with a fractional interest in a purchasing corporation is unlikely to be motivated by self-interest.

It is proposed that section 28 be amended to require agents to disclose their interests only if their interest in the purchasing corporation is greater than 5 per cent.

Section 48 - Agent to Act as Stakeholder

Section 48 allows an agent to unilaterally deduct commission from money held in trust. This section requires an agent to hold, in trust, any funds received as stakeholder for both parties to the transaction. If a dispute arises as to entitlement to the funds, the agent may apply to the Supreme Court to pay the funds into court. However, an agent may deduct the commission from the trust account without court permission.

Section 48 - Agent to Act as Stakeholder (Continued)

It is proposed that section 48 be amended to require agents to obtain court approval before deducting their commission from trust funds. Disputes do arise as to agent's entitlement to commissions (i.e., when a vendor reneges on an agreement to sell). These disputes should be resolved by the courts rather than the unilateral actions of the agent.

4. HOUSEKEEPING CHANGES TO THE REGULATIONS

Regulation 4.01

This regulation sets out the requirements for obtaining a licence under the Act. The regulation requires applicants to be at least 21 years of age, have completed the required courses and, in the case of an application for licence as an agent, be in sound financial condition.

It is proposed that this regulation be changed to require applicants to be 19 years of age and to meet post-licensing requirements. The Council would have the ability to waive this requirement if it believes the applicant has the equivalent in training and experience. People applying for licences as nominees would also have to prove they are financially sound.

Regulation 4.10

Regulation 4.10 allows the Superintendent to grant a temporary licence to the executor or administrator of the estate of a deceased agent. It is proposed that this regulation be amended to maintain the licences of salesmen employed by the deceased agent.

Regulation 4.18

No provisions exist which ensure that trust funds have been properly distributed after an agent's licence has been suspended, cancelled or expired. It is proposed that a new regulation will require an agent to submit a statutory declaration specifying the distribution of trust funds when his licence becomes inoperative. Any person who does not comply with this section would commit an offence under the Act.

Regulation 5.02

Regulation 5.02 prescribes a standard of conduct with respect to advertisements. All persons are prohibited from using advertisements which are "false" or "fraudulent".

It is proposed that Regulation 5.02 be amended to prohibit advertising which is reasonably capable of misleading the public. An advertisement may deliberately confuse or mislead a reader without being false.

Regulation 5.03

Regulation 5.03 currently forbids the placing of "For Rent" or "For Sale" signs by agents on property without the consent of the owner. It is proposed that this section be broadened to prevent agents from publishing advertisements for the sale or rental of property without the owner's consent.

Regulation 6.01 and Regulation 9.16

Regulation 6.01 and Regulation 9.16 set out the requirements for operating a branch office. Regulation 6.01 states that the Superintendent must approve of the nominee running the branch office, and must issue a licence for the branch. Regulation 9.16 requires an agent or a nominee to be in charge of the branch office. However, neither regulation refers to branch manager salesmen who were licensed between 1976 and 1980.

These regulations should be amended to permit branch manager salesmen, as well as nominees, to operate a branch office. Branch manager salesmen were licensed specifically to operate branch offices. Although these types of licences are no longer issued, many of these salesmen are still operating. It is proposed that this regulation be amended to accommodate those licences that still exist.

Regulation 9.17

It is proposed that a provision be added requiring a salesman to surrender his licence if an agent or nominee is not working at the branch office pursuant to regulation 9.16. A salesman should have an onus to ensure he is being properly supervised.

Regulation 9.18

The definition of "agent" under the Act includes publishers of real estate advertisements. Section 1 defines "agent" to include a person who:

> (g) is not exempted by the superintendent and solicits or procures publication, or promises to publish or procure the publication, of any printed advertisement or circular concerning real estate transactions,

This definition is too broad and requires newspapers which publish real estate advertisements to obtain an exemption from the Superintendent. The true purpose of this definition is to capture people who attempt to sell real estate by publishing advertisements in return for a commission on the sale price. Some broad exemption should be enacted to exclude regular publications from this definition of agent.

Regulation 9.18 (Continued)

It is proposed to enact a new Regulation 9.18 which would exempt from the definition of "agent" a person who publishes real estate advertisements in return for a fixed charge. These advertisers will not be allowed to take part in an offer or sale of real estate and will not be able to discuss the property with a potential purchaser.

Regulation 12.01

Regulation 12.01 sets out, in general terms, the business records an agent is required to keep. Agents must keep sufficient records to account for money received on behalf of others.

A broad, general regulation is needed to cover the different situations that may arise in practice. Regulations will never be specific enough to cover all eventualities. However, some additional detail in this regulation may serve to illustrate the duty to keep proper records.

It is proposed that Regulation 12.01 be amended to specifically require that monthly trust reconciliations be kept by agents and to require agents to keep trust records for at least ten years, the statutory limitation period for actions involving trust accounts.

Regulation 12.05

The regulations are silent as to how trust funds which represent a commission should be divided among the various claimants. If adverse claimants to trust funds exist, the agent may pay the funds into court pursuant to section 48. This procedure could be used to settle claims to commissions held in trust.

However, a simple procedure should exist for dividing commissions held in trust among the various parties. More than one party may make a claim for a commission being held in trust. In some circumstances, the claims will be greater than the amount held in trust. Currently, an agent may unilaterally deduct his claim from funds he holds. An adverse claimant must obtain a court order to prevent this from happening. The division of the trust funds is a complex legal issue without a statutory formula.

It is proposed that, subject to any prior agreement between the parties, commissions held in trust by agents should be distributed on a pro rata basis. An agent's share in the trust should be proportional to the amount owed to him. The funds would be paid into court if the parties could not agree on the amount owing to each claimant.

Regulation 14.02

A new Regulation 14.02 should be enacted to exempt traders in timber land and timber licences from the requirements of the Act. Timber land and licences may fall under the legal definition of "real estate".

The Act should not apply to timber traders. Transactions involving timber land and licences are carried out between sophisticated parties who do not require the protection of the Act. Requiring timber traders to comply with the Act would increase costs and regulation needlessly.

Regulation 10/85

It is proposed that section 4 of Regulation 10/85 of the Act be amended to add the following subsection:

> (3) A hearing under this section may be conducted by a hearing committee of not fewer than three members of the council appointed by the council.

This amendment would clarify that a hearing committee may be composed of three members. That makes the regulation consistent with section 20(4) of the Act.

5. CONCLUSION

The proposed amendments are designed to rationalize and improve the regulation of the real estate industry in British Columbia. The Office of the Superintendent of Real Estate would be reorganized and the approval of real estate developments would be streamlined. The proposed amendments would increase the protection of the public by creating a recovery fund, allow freer access to the real estate industry and make a number of technical improvements to the Act.

CHAPTER 2

AMENDMENTS TO THE MORTGAGE BROKERS ACT

1. INTRODUCTION

The original purpose of the Mortgage Brokers Act (MBA) was primarily to protect mortgagors. The Act requires mortgage brokers to be licensed and to disclose the true cost of the mortgage to borrowers. The MBA currently does nothing to protect investors who rely on mortgage brokers to find suitable borrowers.

Mortgage investors, like depositors and investors in securities and real estate, require some statutory protection. The purpose of regulation of the financial sector is to facilitate efficient financial intermediation, the matching of borrowers and lenders. The entire economy relies on an efficient financial sector.

Regulation is required so that those with savings have the confidence to provide their funds to those wishing to borrow. Financial institutions which provide mortgages are regulated by a number of statutes, including the British Columbia Financial Institutions Act (FIA). These statutes protect depositors by requiring deposit insurance and by other measures. Depositors require this protection because they do not have easy access to the information necessary to evaluate the financial institution.

Individuals who provide or arrange mortgages are regulated by the MBA. The MBA does not currently protect mortgage investors although other legislation of general application, like the Criminal Code, does provide some protection. Mortgage investors, like depositors in financial institutions, require some protection because they do not have easy access to information needed to evaluate their investment.

This paper proposes that the MBA be amended to provide protection to mortgage investors. The regulation would be similar, in principle, to that for securities - requiring disclosure of material information to investors and increasing regulators' ability to police inappropriate activities of mortgage brokers.

In general, mortgage activity is less varied or complex than securities activity so the regulatory regime can also be less complex.

2. DEEMED REGISTRATION

The current MBA deems licensees under the Real Estate Act and the Securities Act to be mortgage brokers registered under the MBA. This "deemed registration" has made it difficult to regulate mortgage brokers. Deemed registrations have made it impossible for regulators to know who is acting as a mortgage broker and have resulted in different regulatory requirements for those who are only mortgage brokers and those who are also real estate agents or securities dealers. For example, those who are actually registered under the MBA must submit financial statements. Deemed registrants are not subject to such a requirement. Deemed registration also makes it necessary for the Registrar of Mortgage Brokers to rely on the Superintendent of Real Estate and the Securities Commission to discipline realtors and securities agents acting as mortgage brokers.

On the other hand, there is no compelling reason why real estate agents and securities agents require the status of mortgage brokers. Realtors, in particular, are permitted by the Real Estate Act to deal with mortgages incidental to their primary business.

It is proposed that everyone engaged in the business of mortgage brokering be required to be specifically registered under the MBA. Real estate agents and securities agents will be allowed to hold dual registration. Real estate and securities agents who can demonstrate they currently practice extensively in this area may be permitted to register without passing examinations normally required of new applicants.

3. LICENSING CATEGORIES

"Mortgage brokers" engage in a broad range of activities. Some brokers primarily refer borrowers to lending institutions. Other brokers primarily arrange lending opportunities for investors. Still other brokers borrow money from investors and re-lend it to borrowers. The current definition of "mortgage broker" in the MBA does not distinguish among these activities.

It is proposed that the MBA be amended to create categories of mortgage brokers so that different activities can be regulated differently. For example, some categories of mortgage brokers would be licensed, rather than registered, as is currently the case. The term "license" better reflects the fact that the MBA would provide a complete regulatory environment, and is consistent with the terminology of the Real Estate Act, the Financial Institutions Act and other statutes. The term "registration" may imply a lower level of regulation. In keeping with these changes, the Registrar of Mortgage Brokers would be referred to in the future as the "Superintendent of Mortgage Brokers".

3. **LICENSING CATEGORIES** (Continued)

One category, the "agent" category, would consist of brokers who simply refer borrowers to financial institutions or other mortgage brokers. These brokers would not be permitted to solicit or accept funds to be invested in mortgages. Brokers licensed in this category are being relied on by borrowers, but not by investors.

A second category, the "advisory" category, would consist of brokers who solicit funds to be re-lent directly, arrange syndicated mortgages for investors or refer investors to borrowers. This particular category of licence would allow brokers to provide advice intended to be relied on by investors.

A third category, the "investor" category, would consist of mortgage brokers who themselves invest in more than ten mortgages per year as mortgagee. Brokers in the investment category are not relied on for information and advice, nor are they responsible for anyone's money except their own. The activities of this category of mortgage broker are regulated solely to protect borrowers from unethical lending practices. Brokers in this category would be registered rather than licensed, and would be subject to only a modest amount of regulation.

4. **LICENSING REQUIREMENTS**

It is proposed that the MBA recognize different requirements for different categories of licenses.

Applicants for an agent licence would require a minimum of $5,000 capital. "Capital" in this context refers to surplus of assets over liabilities, rather than the definition of "working capital" contained in the present regulations. This requirement exists under the current Act and helps ensure only financially responsible people can qualify. As noted above, borrowers will rely on the advice of brokers in this category. Therefore, the MBA should continue to require completion of formal training courses in order to qualify for this type of licence. A real estate agent or securities dealer would qualify for an agent's licence without any additional formal training.

The MBA would require applicants for the advisor category of licence to successfully complete formal training courses and to maintain $25,000 in capital. This is the same capital requirement imposed by the Securities Act upon real estate security dealers. Alternatively, the Superintendent of Mortgage Brokers may permit an applicant to post a bond if the applicant can demonstrate a history of financial responsibility.

4. **LICENSING REQUIREMENTS** (Continued)

It is not proposed that applicants for registration in the investor category be required to maintain a minimum amount of capital or take prescribed courses. Registration of investors under the MBA is designed to protect borrowers from improper disclosure. Capital and education requirements would not enhance this protection.

Transition provisions will be established to accommodate persons currently operating as mortgage brokers. Persons who can demonstrate, to the satisfaction of the Superintendent, that they have been operating as mortgage brokers in the agent or advisor categories, may not be required to take additional formal training. In these cases, the capital requirements could be relaxed, and a combination of capital and bonding substituted.

5. **DISCLOSURE - CONVENTIONAL MORTGAGES**

The principle underlying the proposed changes to the MBA is that the best way to ensure adequate protection for investors is to ensure that they receive complete, accurate and clear information on which to base their decisions. The Act does not presently require brokers to disclose any information to mortgage investors. Market forces do, of course, result in good disclosure in most cases. There have, however, been examples where disclosure has broken down to the detriment of investors.

It is proposed that mortgage brokers be required to reveal basic information about the mortgage investment. The Act would require disclosure of the the broker's interest in the investment, as well as the interests of related parties. What constitutes an interest in an investment, and the determination of parties related to the broker, would be defined in terms compatible with similar provisions in the Securities Act and the Real Estate Act.

Brokers will be required to reveal the state of title of the property being mortgaged and the existence of any prior encumbrances. Material terms of the mortgage, including principal, interest rate and amortization period, would also have to be revealed. Mortgage brokers would have to disclose their fees for arranging the mortgage and obtain a written agreement setting out fees and other terms if they are to administer a mortgage.

5. **DISCLOSURE - CONVENTIONAL MORTGAGES** (Continued)

Brokers should also be in a position to inform investors about the current market value of the property. It is proposed that mortgages with a total value of over $20,000 require a recent appraisal completed by an accredited appraiser if the lender is not a financial institution. Smaller mortgages would not require a formal appraisal, but would still require a written valuation. However, the absence of an appraisal would have to be revealed, as well as the basis for the valuation.

The information listed above is crucial in determining whether adequate security is being offered for the loan. It is also information which should be readily available to brokers.

It is proposed that brokers be required to reveal this information in a prescribed disclosure form. Mortgage brokers would be required to keep a copy of the disclosure form for six years. The disclosure form would not be vetted by the Superintendent of Mortgage Brokers. However, there would be strict penalties for providing incomplete or inaccurate information. As well, the MBA will require brokers to provide mortgage investors with copies of registration documentation, such as an executed copy of the mortgage, the state of title certificate and a solicitor's opinion on the state of title.

6. **DISCLOSURE - SYNDICATED MORTGAGES**

"Syndicated" mortgages are mortgages where a number of independent investors lend money to a borrower on the security of a single mortgage. It is becoming increasingly common for mortgage brokers to arrange these types of mortgages on behalf of their clients. Often the mortgage broker will also be responsible for administering the mortgage on an ongoing basis. Syndicated mortgages pose special problems for investors. Unlike conventional mortgages, it may not be clear who is in charge of administering the mortgage. For example, in cases where there are dozens of mortgagees, it may not be clear which mortgagee has the right to commence foreclosure proceedings or take other action. Parties should know who is to collect the mortgage payments, discharge the mortgage upon satisfaction of the debt and commence enforcement procedures if necessary. Parties should also know who is financially responsible for these services and their cost.

5. **DISCLOSURE - SYNDICATED MORTGAGES** (Continued)

It is proposed that mortgage brokers be required to disclose this administrative information on the disclosure statement.

Syndicated mortgages are generally securities falling within the ambit of the Securities Act. Mortgages are exempted from the registration and prospectus requirements of the Securities Act provided certain conditions are met, including that the mortgage is offered for sale by a person registered or exempted from registration under the MBA.

Mortgage brokers should not be allowed to sell investments in mortgages which are so complex or uncertain that the fuller disclosure requirements of the Securities Act should apply. Therefore, the MBA will be amended to provide that mortgage brokers will be allowed to solicit investments only in mortgages which meet the following criteria:

- the investor receives all the rights of a mortgagee and his interest in the mortgage is registered on the title of the property;
- there is no guarantee of return on the investment offered by the offerer; and
- the rate of interest offered to the investor is not different from that stated in the mortgage.

Syndicated mortgages that do not meet these criteria could not be sold by persons registered or exempted from registration under the MBA. These syndicated mortgages would, therefore, not be eligible for the Securities Act exemptions provided for mortgages offered for sale by such persons and could only be sold in compliance with the registration and prospectus requirements of the Securities Act or under another exemption provided in the Act.

7. **TRUST ACCOUNTS**

The current MBA does not require that brokers hold investors' funds in trust accounts, although many brokers do hold client funds in trust.

It is proposed that all mortgage brokers in the agent or advisor categcry be required to keep investors' funds in separate trust accounts. Audited trust statements would have to be submitted to the Superintendent of Mortgage Brokers once a year. Failure to submit an audited trust statement would result in a substantial fine imposed by the Superintendent and possible loss of registration.

7. **TRUST ACCOUNTS** (Continued)

Submitting an audited trust statement is already a condition of registration. Making the submission of a trust statement a statutory requirement will ensure that the Superintendent can impose a penalty if a broker fails to comply.

8. **FINANCIAL STATEMENTS**

It is proposed that mortgage brokers in the agent and advisor categories would be required to submit audited financial statements once a year. This is necessary to ensure compliance with the minimum working capital requirements. Mortgage brokers in the investment category would be permitted to submit unaudited statements supplemented by a list of all mortgage transactions they have entered into.

Submitting annual financial statements is already a condition of registration. Making financial statements a statutory requirement will enable the Superintendent to impose a penalty if a mortgage broker does not meet this requirement.

9. **REGULATORY POWERS**

The current Act allows the Superintendent to ban specific advertisements, but does not allow the Superintendent to set specific guidelines for advertising, or require that advertisements contain specific information. It is proposed that the Lieutenant Governor in Council have the power to specify guidelines and rules for promotional materials and advertising in regulations.

The current Act allows the Superintendent to de-register a broker if the broker has breached the MBA. The Superintendent has had no effective remedy, however, if a licensee has continued to act as a mortgage broker after his licence was suspended.

It is proposed that the MBA provide the Superintendent with powers similar to those contained in the Securities Act. The Superintendent would have the ability to order a person to cease trading, or to no longer trade a particular mortgage. A licence could be suspended, or conditions could be placed on it. The Superintendent would have the ability to apply to court for an order directing a person to comply with or cease violating an order, a condition of a licence or the Act. The Superintendent would have the ability to appoint a temporary receiver of a broker's business if the broker has ceased to carry on business, and the power to freeze the trust account of a broker.

9. **REGULATORY POWERS** (Continued)

The Superintendent now has the power, under section 6 of the MBA, to seize and inspect documents and records of a broker under investigation. However, there is no obligation on brokers to keep their records at their place of business. The ability of the Superintendent to inspect records can be hampered if he does not know where the records are being kept. It is proposed that brokers be required to file the location of their office with the Superintendent and keep their files and business records there.

Finally, the MBA provides for fines of up to $5,000 and six months' imprisonment for violating the Act. This is not a sufficient deterrent for brokers involved in sizeable transactions. The Securities Act, for example, provides for fines of over $1 million and three years' imprisonment for deliberate misrepresentations.

It is proposed that the MBA be amended to provide for two levels of offences. The first level of offence would consist of less serious offences, such as failing to make a required filing, and will carry a maximum fine of $5,000 which may be levied by the Superintendent. The second level of offence would consist of more serious offences, such as deliberately misleading investors or borrowers, and would carry fines of up to $100,000 and two years' imprisonment for the first offence. Fines for subsequent offenses will increase to $200,000. A similar pattern of fines exists in the Financial Institutions Act.

Appeals from regulatory actions by the Superintendent will continue to be heard by the Commercial Appeals Commission.

10. **CONCLUSION**

The primary objective of the proposed amendments to the MBA is to increase the protection afforded to investors in mortgages. This objective would be accomplished primarily by outlining information that must be provided to investors by mortgage brokers. Amendments are also proposed to increase the ability of the Superintendent of Mortgage Brokers to supervise the activities of mortgage brokers.

Although the proposed amendments should increase protection, they should not significantly increase costs to mortgage brokers. The majority of the proposed amendments (i.e., disclosing conflicts of interests or requiring appraisals) is already normal business practice for all reputable mortgage brokers. The amendments will simply codify existing standards.

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